UCITS IV DIRECTIVE ON SUPPORTING AN INTEGRATED FINANCIAL MARKET WITHIN THE MANAGEMENT COMPANY PASSPORT (MCP)

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Abstract

This paper aims to add contribution to the Romanian mutual fund market research by examining how the UCITS IV regulation on the Management Company Passport (MCP) implementation may influence the attractiveness of cross-border investments and particularly, the Romanian investment fund industry. We first explore the potential benefits of MCP prospects for the Romanian investment fund market. At the same time, we also investigate whether these benefits are consistent and may increase the market competition in order to drive to new opportunities for greater internal market efficiencies, rather than the disadvantages apparent outcomes in form of increased investor protection and creating cost savings by shifting investments in order to chase for new incentives.

Key words: *cross-border funds, cross-border management, master-feeder, CESR*

JEL Classification: F21, G15, G18, O16

1. THE MCP CONCEPTUALIZATION

The Management Company Passport (MCP) was first introduced in Directive 2001/107/EC (the Man Co Directive)[3]. Later in 2005, the Committee of European Securities Regulators (CESR) issued certain clarification on the MCP procedures which were not included in the initial UCITS IV Directive. Consequently on the 31st October 2008, CESR issued its advice to the Commission on the introduction of an effective full MCP which had a specific framework in order to apply the UCITS IV Directive on the MCP implementation. For instance, Germany, Ireland, Luxembourg and the UK also successfully implemented UCITS IV by the July 1 deadline.

Prior to the introduction of the UCITS IV Directive, management companies had not enjoyed parallel cross-border freedoms, as the management company of a UCITS was required to be domiciled in the same member state as the UCITS which it managed[4]. Therefore, the UCITS IV provisions permit UCITS funds to be managed on a true cross-border basis for the first time (see Figure 1).

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[3] http://www.dilloneustace.ie/download/1/UCITS%20Management%20Company%20Passport.pdf

[4] http://www.matheson.com/images/uploads/publications/UCITS_IV_Management_Company_Passport_WEB_APR_13.pdf

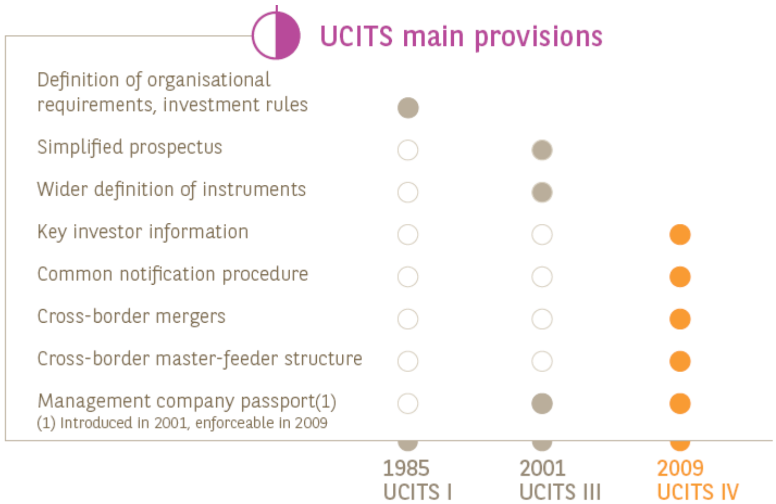

Figure 1.

Source: (BNP Paribas Securities Services, feb.2010)

However, the UCITS IV[5] (*Directive 2009/65/EC)* framework contains the following six measures for supporting the creation of a single European market for investment funds (KPMG, EFAMA, 2010 Jun.):

- a framework for cross-border UCITS mergers under which cross-border mergers between all types of UCITS funds (contractual, corporate and unit trust) are allowed and recognized by each Member State.
- a full passport for a UCITS Management Company which will allow a UCITS established in one EU Member State to be managed by a Management Company in another Member State.
- the creation of cross-border Master-Feeder UCITS structures which will allow Feeder funds to invest at least 85 percent of their assets into another UCITS fund i.e. the Master fund.
- replacement of the Simplified Prospectus with the Key Information Document (KID) which is designed to help investors reach an informed investment decision by presenting key technical information in a concise, non-technical and easy-to-read manner.
- a new notification procedure for the cross-border marketing of UCITS in the EU to remove administrative obstacles and delays to cross-border distribution of UCITS, with the aim of improving time to market and reducing costs.
- supervision measures that are aimed at improving cooperation mechanisms between national supervisors and are also designed to minimize or remove administrative obstacles and delays.

Following UCITS IV, fund operators will be able to consolidate their existing business model, managing all their UCITS by one single Management Company (KPMG, EFAMA, 2010 Jun.).

Moreover, it has been promoted the idea that the UCITS stamp is seen not just as a European fund passport, but as a global one[6] (Thomson Reuters, LipperFMI, 2010).

Today, one of the key aims of UCITS IV is to enable the Management Company authorized in one Member State of the EU to manage, administer and market a UCITS

[5] Referred to as "UCITS IV", Directive 2009/65/EC was published in the Official Journal of the EU (the "OJ") on 17 November 2009

[6] http://www.lipperfmi.com/FERIFMI/Information/Files/Symbiosis%20in%20Ucits%20Evolution.pdf p.38

authorized in another EU Member State jurisdiction (KPMG, EFAMA, 2010 Jun.). Therefore, a Management Company has a choice when deciding to carry out operations in another Member State: it can either do so by setting up a branch in another Member State or providing services under the freedom to provide services without the establishment of a branch. The branch would not be subject to any authorization requirement in the Member State or to any additional capital requirements (Quinn, 2011). For instance, a management company set up and authorized in Ireland by the Irish regulator can create and manage common funds set up and authorized in Germany.

As a consequence, the MCP allows the authorization of financial institutions in order to activate in all the European markets based on a single agreement from the domicile country authority (Filip, 2008). Therefore, for the mutual funds case, the asset management companies are entitled to select or create new branches under providing the freedom to services. Once with this authorization, the asset management companies can distribute their unit funds on new prospective European markets. Also, the asset management companies might manage the assets and the portfolio of the new created investment company (Sava & Radu, 2012).

In addition, Quinn J. (2011) complements that the main objective of the UCITS project was to foster the development of the European single market beside the industry consolidation and efficiency constrains. In addition, it was hoped this objective would offer greater business and investment opportunities, for both industry and investors by removing Member States barriers for the provision of financial services throughout the European Community.

As a consequence, such cross-border management involves increased interaction and engagement between member state regulators, following two sets of rules:

-first, the rules of the management company's home member state as regards organizational requirements, rules of conduct and prudential requirements and

-second, the rules of the UCITS' home member state in relation to the constitution and functioning of the UCITS.

Accordingly, the passporting application assumes that the authorization of a UCITS may generate several benefits. For instance, IFIA (2012) presents the following key considerations regarding the supplementary benefits of the UCITS IV on the MCP:

- maximize distribution capabilities
- optimize tax efficiency
- regulatory efficiency and experience
- advanced oversight and compliance policies and systems
- complex servicing requirements
- local regulatory and tax expertise
- technology platforms and systems
- cost reductions

Also, BNP Paribas Securities Services White paper report enhances the following three main benefits of the MCP (see Figure 2):

- enhances the investors protection
- initiates the expansion of cross-border distribution of funds and their unit funds
- creates economies of scale in terms of costs in order to have less management companies. Regarding this, Quinn J. (2011) also identifies and presents that the rationale behind the MCP is to create economies of scale and reduce costs in the investment fund market. Furthermore, it will allow for the creation of centres of excellence while at the same time allowing companies the freedom to locate operations around Europe and through cross border business models in management and administration.

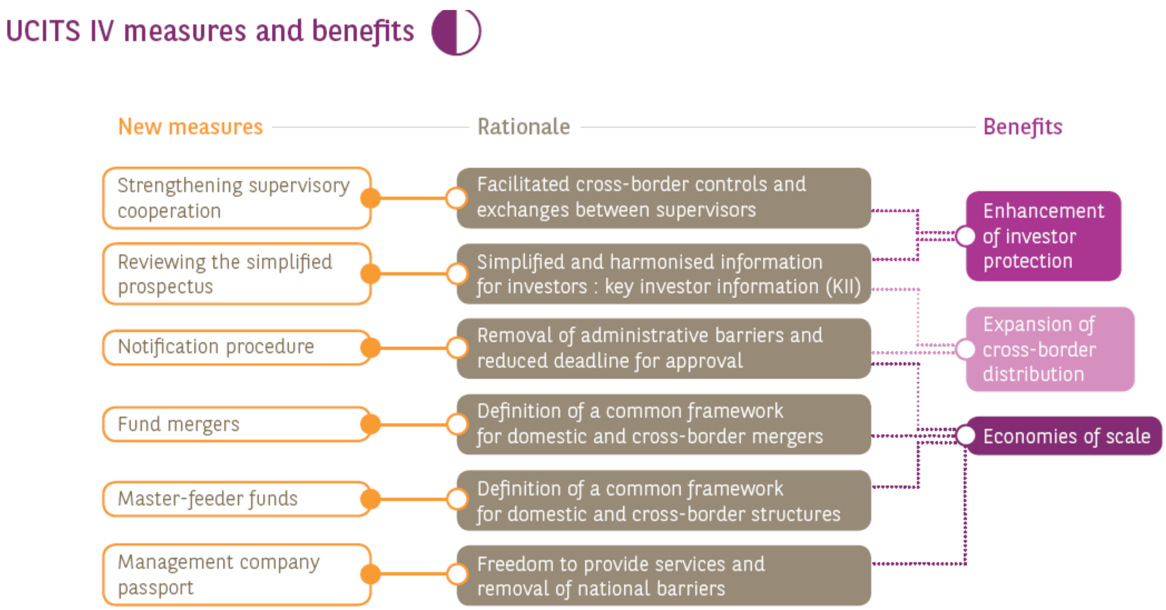

Figura 2. UCITS IV measures and benefits
Source: BNP Paribas Securities Services, White Paper

BNP Paribas report on 'The future of the Management Company' presents the main factors that may affect the strategy of asset managers toward the Management Company (re)location, i.e. the tax impact, the regulatory framework, reputational and distribution issues, target markets and preferred/existing locations and organizational structure of the asset manager concerned. Also, the new different local accounting rules and policies, financial reporting and regulation system, the various rules on investment valuation across the EU, will rise challenges for asset managers using the MCP facility. Furthermore, asset managers will decide to merge their local and foreign management companies, liquidate some Management Companies, maintain a local branch in their preferred UCITS domicile, retain the status quo or adopt a different approach (BNP Paribas Securities Services, feb.2010).

Even so, Quinn J. (2011) concludes that MCP disadvantages outweight its advantages. For example, instead of increasing competition and delivering real economies of scale, the MCP may not be able to overcome the market status quo and therefore, will not overcome obstacles such as consumer preferences and existing distribution channels. However, the largest hurdle for MCP is that it will face the taxation regime across the Member States, as the financial savings envisaged by the MCP can easily outweighted by Member States' taxes on the profits of foreign UCITS. As a consequence, it has been suggested that MCP will need a new Directive on the taxation of UCITS in order to be drawn up.

Table 1 The advantages and disadvantages of the MCP

Advantages / Positive outcomes	*Disadvantages of the MCP*
- there are around 32,000 UCITS products in Europe, representing over EUR 6 trillion of assets under management and about 79% of the total assets of European investment funds market. - is removing Member States barriers for the provision of financial services throughout the European Community.	- Ineffective supervisory framework that would roll back the clock on the single market and prevent the development of a true European market for funds (Quinn apud Waters D., 2011). - Policy obstacles - „policy induced" and „natural" obstacles. Policy induced hurdles to cross border sales of funds

- reforms the legislation - Helps foster a single European Market for investment funds, establishing a single market in wholesale financial services, making retail markets open and secure and strengthening the rules on prudential supervision. - stock market investments get more accessible to the public and diversify the portfolios of private investors without the constraint of managing each fund individually. - The rationale behind the MCP is to create economies of scale and reduce costs in the investment fund market. It will allow for the creation of centers of excellence while at the same time allowing companies the freedom to locate operations around Europe and through cross border business models in management and administration. - Increase in competition. The MCP will improve competition by lowering the barriers of entry for small and medium sized firms to operate across Europe, as they do not need capital to establish offices and employ staff across Europe. In turn, improved competition will help to ensure that consumers benefit from the economies of scale. Moreover, it is expected that the MCP will fulfill the objectives of the EU Treaty, by bringing freedom to provide cross-border services, at last for the asset management industry. - Strengthened supervision. The MCP will provide a high level of investor protection. The MCP strengthens investor protection by improving transparency of the management structure and enabling more effective management by the centralization of functions in the core of the asset management business. That is, instead of having a number of offices across Europe, a Management Company can centralize its functions in one office, while being able to manage funds in a number of Member States on a pan-European basis. - Cost savings are expected and therefore delivering real economies of scale - Opportunities to optimize cross-border distribution - Opportunities for greater internal efficiencies	include, for instance tax discrimination of foreign funds, and can be directly dismantled by appropriate adjustments of EU and national legislation. Natural obstacles resulting from consumer preferences or the inherent characteristics of the market are not under the control of policy makers. Natural obstacles to cross border sale of funds in Europe envisaged under the MCP could result from first *a)* consumer preferences and *b)* existing distribution channels. Experts argue that the scalability from the marketplace and technical infrastructure found in centers such as Dublin and Luxembourg are hard to replicate. An additional attraction of these centers for consumers is that this expertise base brings with it greater consumer confidence and in turn attracts consumers, as their investment may be exposed to less risk in the hands of experienced management companies. The distribution obstacle is „natural‟ in the sense that legislators do not have direct instruments to overcome it. Based on market forces alone, an open architecture for their distribution is still lagging behind. A major part of funds are sold over the bank counter. Banks often advise their customers with a bias towards fund products in their own group rather than towards the best performing funds. However due to **taxation aspects** not being included within the scope of the Directive, it can be anticipated that taxation issues could create obstacles to the effectiveness for the MCP. It is anticipated the MCP will be hindered by *a)* discrimination caused by Members States treating non-resident UCITS differently from resident UCITS and *b)* the diversity in Member States‟ national tax legislation

Source: (Quinn, 2011), (BNP Paribas Securities Services, feb.2010)